
**SOUTHWESTERN
POWER ADMINISTRATION**

**ANNUAL
REPORT**

2012

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Department of Energy
Southwestern Power Administration
One West Third Street
Tulsa, Oklahoma 74103-3502

The Honorable Dr. Ernest Moniz
Secretary of Energy
Washington, D.C. 20585

Dear Secretary Moniz:

I am pleased to present the financial statements and operating data for Southwestern Power Administration (Southwestern) for Fiscal Year (FY) 2012.

In FY 2012, Southwestern delivered over 4.1 billion kilowatt-hours of energy to its wholesale customers in Arkansas, Kansas, Louisiana, Missouri, Oklahoma, and Texas, generating \$195 million in revenue.

In fulfilling its mission to market and reliably deliver renewable Federal hydroelectric power, Southwestern maintains 1,380 miles of high-voltage transmission lines, substations, and communications sites, contributing to the reliability of the regional and National electric grid. Southwestern also actively partners with the Department of Energy, the U.S. Army Corps of Engineers, Southwestern's customers, and other Federal power stakeholders to most effectively balance their diverse interests with Southwestern's mission while continuing to maximize Federal assets to repay the Federal investment in the 24 hydropower facilities within Southwestern's marketing region.

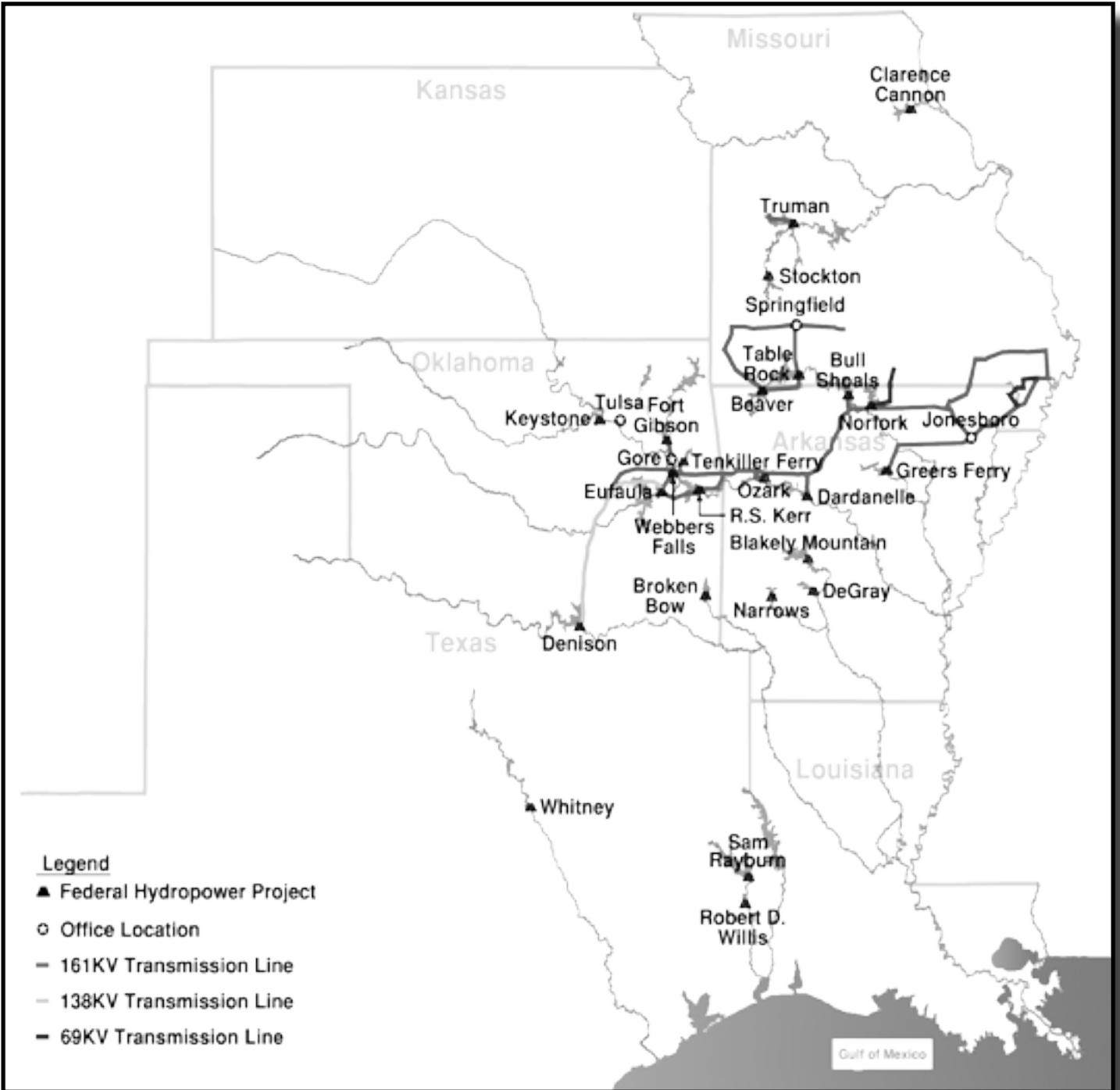
Southwestern is proud of its past successes, and we look forward to continuing to serve the Nation's energy needs in the future.

Sincerely,

A handwritten signature in black ink, appearing to read "C. M. Turner", is written over a light blue circular stamp.

Christopher M. Turner
Administrator

SOUTHWESTERN SYSTEM MAP



ABOUT SOUTHWESTERN

Southwestern was established in 1943 by the Secretary of the Interior as a Federal Agency that today operates within the Department of Energy as authorized by Section 5 of the Flood Control Act of 1944.

As one of four Power Marketing Administrations in the United States, Southwestern markets hydroelectric power in Arkansas, Kansas, Louisiana, Missouri, Oklahoma, and Texas from 24 U.S. Army Corps of Engineers multipurpose dams with a generating capacity of approximately 2,174 MW.

By law, Southwestern's power is marketed and delivered to not-for-profit municipal utilities and rural electric cooperatives. Southwestern has over one hundred such "preference" customers, and these entities ultimately serve over eight million end-use customers.

Southwestern operates and maintains 1,380 miles (2,220 km) of high-voltage transmission lines, substations, and a communications system that includes microwave, VHF radio, and state-of-the-art fiber optics. Staff members work from offices located in Gore, Oklahoma; Jonesboro, Arkansas; Springfield, Missouri; and Tulsa, Oklahoma. Power scheduling and plant dispatching are conducted on a 24-hour basis by staff in the Springfield Operations Center.

Annual revenue for Southwestern averaged approximately \$175 million from 2008 to 2012. This revenue is used to pay the cost of operating and maintaining the generation and transmission facilities and to repay the principal and interest on the Federal investment.

MISSION

Southwestern Power Administration's mission is to market and reliably deliver Federal hydroelectric power with preference to public bodies and cooperatives.

This is accomplished by maximizing the use of Federal assets to repay the Federal investment and participating with other water resource users in an effort to balance their diverse interests with power needs within broad parameters set by the U.S. Army Corps of Engineers, and implementing public policy.

VISION

Southwestern has an open and trusting partnership with its customers in meeting their business expectations for operation of the Federal hydropower system, and with the American public in meeting its financial obligations while providing good stewardship of regional water resources. The Southwestern work force is cost-conscious, team-based, and empowered to meet customer expectations.

AUTHORIZATION

The Flood Control Act of 1944 (58 Stat. 887, 890; 16 U.S.C.A. 825s) is Southwestern's main authorizing legislation. Through Section 5 of this Act and a series of Executive Orders, Southwestern's Administrator is authorized to "transmit and dispose of ... power and energy in such manner as to encourage the most widespread use thereof at the lowest possible rates to consumers consistent with sound business principles." Southwestern is also authorized to draw up rate schedules for such power and energy, with the goal of recovering, with interest, the investment of the American people.

SOUTHWESTERN FEDERAL POWER SYSTEM ENERGY PRODUCTION

Project	Fiscal Year On-Line Date	Installed Capacity (kW)	Estimated Annual Energy ¹ (Millions kWh)	2012 Actual Net Energy (Millions kWh)	Cost Assigned to Power ²	Total Project Cost ²	% Cost Assigned to Power
Beaver	1965	112,000	172	143	63,143,346	94,483,721	66.8%
Blakely Mountain	1956	75,000	169	169	44,837,291	60,705,558	73.9%
Broken Bow	1970	100,000	129	144	29,134,503	50,895,328	57.2%
Bull Shoals	1953	340,000	785	602	77,824,296	117,981,134	66.0%
Clarence Cannon	1985	58,000	90	24	88,882,694	392,877,752	22.6%
Dardanelle	1965	140,000	613	440	86,227,890	131,073,157	65.8%
DeGray	1972	68,000	97	49	30,854,440	84,986,378	36.3%
Denison	1945	70,000	219	71	33,430,772	87,971,018	38.0%
Eufaula	1965	90,000	260	103	41,830,114	146,602,370	28.5%
Ft Gibson	1953	45,000	191	100	25,416,815	68,401,956	37.2%
Greers Ferry	1964	96,000	189	233	39,751,763	64,034,442	62.1%
Harry S Truman ³	1982	160,000	244	130	133,777,958	627,936,904	21.3%
Keystone	1968	70,000	228	132	31,665,662	139,661,563	22.7%
Narrows	1950	25,500	30	30	13,940,878	26,929,984	51.8%
Norfolk	1944	80,550	184	170	28,255,551	82,625,872	34.2%
Ozark	1973	100,000	429	108	134,567,583	194,481,357	69.2%
Robert D Willis ⁴	1989	7,350	37	26	203,616	7,348,132	2.8%
Robert S Kerr	1971	110,000	459	301	54,066,845	117,212,886	46.1%
Sam Rayburn	1966	52,000	114	26	36,076,862	123,482,919	29.2%
Stockton	1973	45,200	55	18	36,719,439	99,233,037	37.0%
Table Rock	1959	200,000	495	398	116,640,721	195,091,983	59.8%
Tenkiller	1954	39,100	95	93	27,656,314	82,750,965	33.4%
Webbers Falls	1974	60,000	213	94	86,669,043	150,558,621	57.6%
Whitney	1955	30,000	73	24	38,325,380	88,864,654	43.1%
Total		2,173,700	5,570	3,628	1,299,899,776	3,236,191,691	40.2%

1 For each of the 24 projects in Southwestern's marketing area, a planning study was conducted by the U.S. Army Corps of Engineers prior to construction to forecast the quantity of energy that could be produced under average hydrological conditions. The term "Estimated Annual Energy" used in the table above represents the quantity of this forecasted energy on an annual basis.

2 Includes construction work in progress with plant in service less contributions in aid of construction.

3 Only 53,300 kW of installed capacity have been declared in commercial operation.

4 The initial project construction costs for power were non-federally financed.

SOURCE AND DISTRIBUTION OF ENERGY

Energy Source	2012 Millions kWh	2012 % of Total
Generated by Corps Plants	3,627.8	87.1%
Direct Purchases	521.1	12.5%
Interchange	8.1	0.2%
Contract Exchange	6.4	0.2%
Total	4,163.4	100.0%

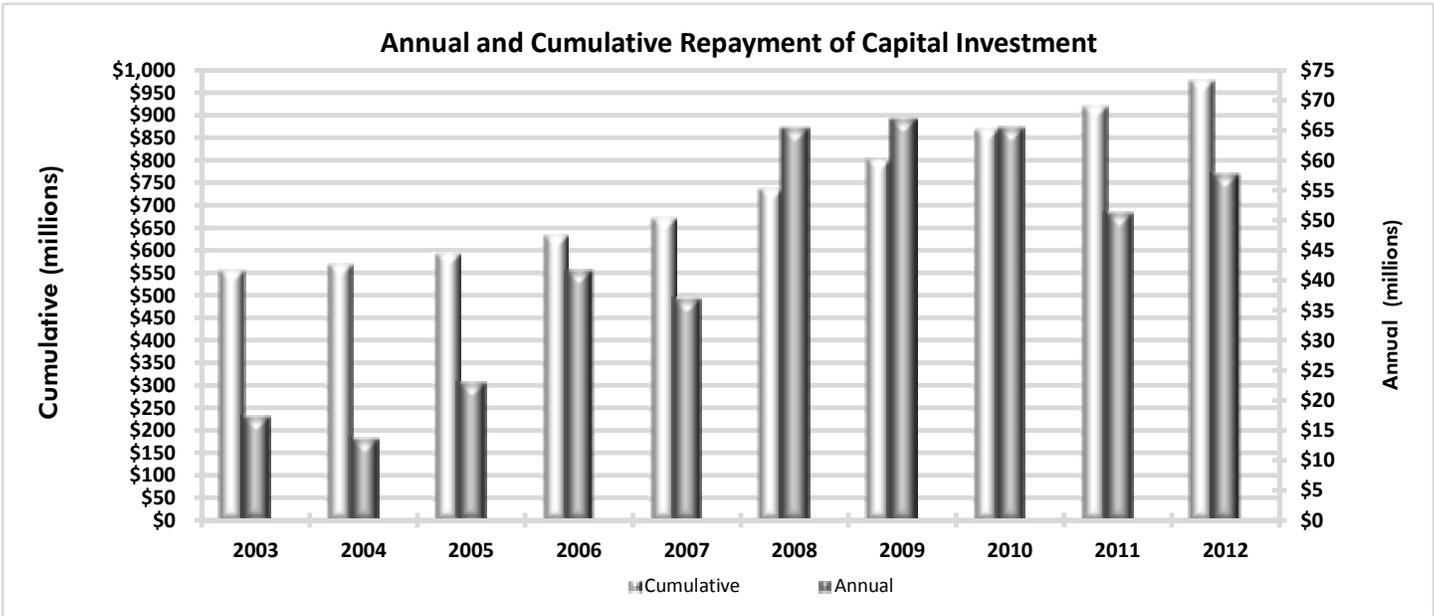
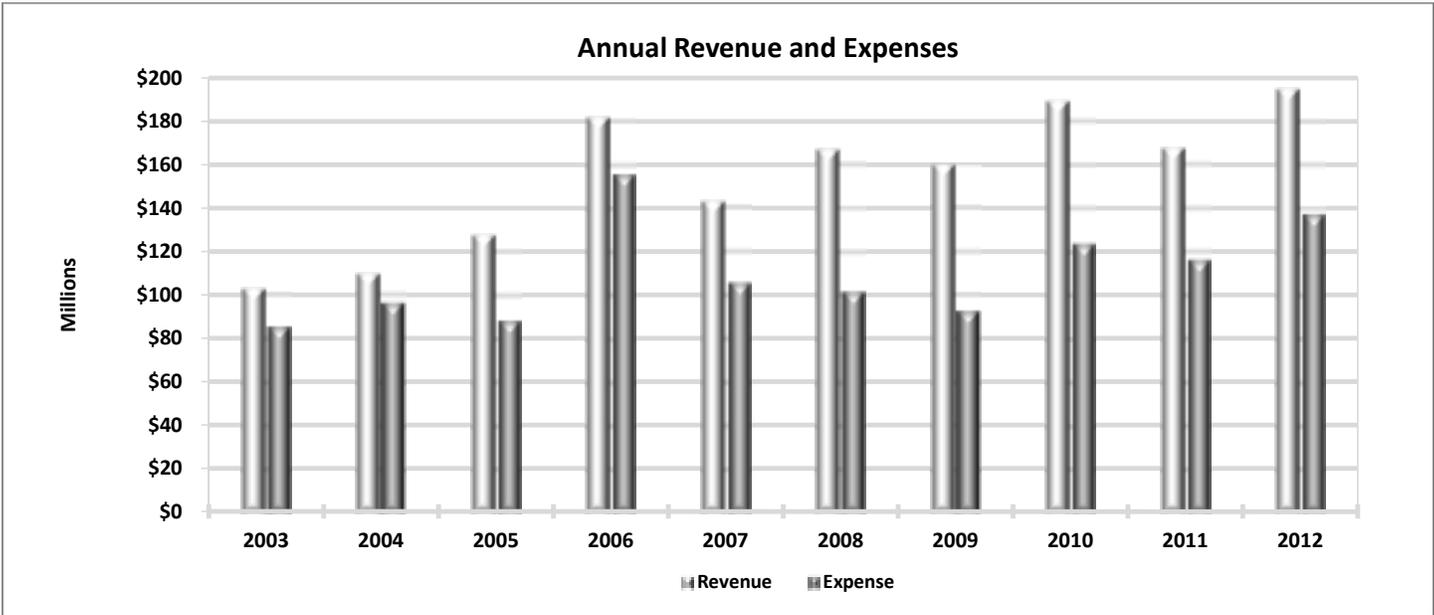
Energy Distribution	2012 Millions kWh	2012 % of Total
Cooperatives	2,756.3	66.2%
Municipalities	1,240.6	29.8%
Government Agencies	98.3	2.4%
Losses	58.9	1.4%
Interchange	8.3	0.2%
Utility Companies / Other	1.0	0.0%
Total	4,163.4	100.0%

SOURCE AND DISTRIBUTION OF REVENUE

Revenue Source	2012 Thousands \$	2012 % of Total
Cooperatives	105,149	53.9%
Municipalities	48,274	24.8%
Miscellaneous	21,069	10.8%
Deferred	16,660	8.5%
Government Agencies	3,451	1.8%
Banking Exchange	305	0.2%
Utility Companies / Others	45	0.0%
Total	194,953	100.0%

Revenue Distribution	2012 Thousands \$	2012 % of Total
Operations, Maintenance, & Other ¹	89,077	45.7%
Available for Repayment	57,284	29.4%
Purchased Power & Banking Exchange	31,777	16.3%
Interest Expense	13,731	7.0%
Transmission Service Charge	3,084	1.6%
Total	194,953	100.0%

1 Includes losses on repayment of assets booked through depreciation reserve.



SOUTHWESTERN FEDERAL POWER SYSTEM FIVE-YEAR STATISTICAL SUMMARY

Revenue	2012	2011	2010	2009	2008
Annual Gross Revenue	\$194,953,241	\$167,463,063	\$189,241,023	\$159,588,111	\$166,943,081
Annual Expense (Excluding Depreciation)	(133,148,118)	(112,440,982)	(110,457,858)	(89,780,407)	(99,594,052)
Net (Deficiency) Revenues	\$61,805,123	\$55,022,801	\$78,783,165	\$69,807,704	\$67,349,029
Retirement Losses	(\$4,195,896)	(\$3,826,479)	(\$13,408,697)	(\$2,873,837)	(\$2,020,240)
Total Funds Available for Repayment	\$57,609,227	\$51,195,602	\$65,374,468	\$66,933,867	\$65,328,789

Repayable Investment

Generation	\$1,066,347,536	\$1,023,716,958	\$1,007,691,769	\$991,267,937	\$988,678,855
Transmission	322,079,152	309,634,000	298,976,824	280,587,206	268,545,518
Total Repayable Investment	\$1,388,426,688	\$1,333,350,958	\$1,306,668,593	\$1,271,855,143	\$1,257,224,373

FEDERAL INVESTMENT IN GENERATION AND TRANSMISSION FACILITIES IN SERVICE

	2012	2011
Generation Facilities	\$1,139,425,949	\$1,096,795,371
Transmission Facilities	322,079,152	309,634,000
Total Investment	\$1,461,505,101	\$1,406,429,371
Adjustments:		
Prior Year	-	-
Retirement work-in-progress	-	-
Dam Safety ¹	(73,078,413)	(73,078,413)
Total Repayable Investment	\$1,388,426,688	\$1,333,350,958

1 Dam Safety work is not repayable per Public Law 99-662.

FY 2012 CUMULATIVE REPAYMENT STATUS

Revenue	Robert D. Willis	Sam Rayburn	Integrated System	Total System
Revenue	\$11,363,256	\$86,697,267	\$4,473,102,949	\$4,571,163,472
Expense				
Operations and Maintenance	10,319,238	42,071,486	1,881,479,104	1,933,869,828
Purchased Power and Transmission Service			818,484,464	818,484,464
Interest	(267,907)	18,320,518	824,323,608	842,376,219
Total Expense	\$10,051,331	\$60,392,004	\$3,524,287,176	\$3,594,730,511
Revenue Applied to Repayment				
(Cumulative Amortization)	\$1,311,925	\$26,305,263	\$948,815,773	\$976,432,961
Total Unpaid Investment	\$(1,108,309)	\$6,839,977	\$406,262,059	\$411,993,727

FY 2012 - DETAIL OF BILLINGS TO CUSTOMERS

	Capacity (kW)	Energy Delivered (kWh)	Billings for Power Sales (Dollars)
Distribution Cooperatives			
Beauregard Electric Cooperative, Inc	8,800	12,744,519	585,208
Claiborne Electric Cooperative, Inc	5,500	7,925,103	363,985
Concordia Electric Cooperative, Inc	4,800	6,941,806	318,775
Dixie Electric Membership Corporation	18,200	26,316,543	1,208,492
Jefferson Davis Electric Cooperative, Inc ¹	3,600	5,608,589	256,779
Kaw Valley Electric Cooperative, Inc	1,000	2,006,000	75,718
Nemaha-Marshall Electric Cooperative Association	1,000	1,985,000	75,413
Northeast Louisiana Power Cooperative, Inc	4,500	6,581,686	302,096
Pointe Coupee Electric Membership Corporation	3,000	4,352,037	199,824
South Louisiana Electric Cooperative Association	8,900	12,900,314	592,340
Southwest Louisiana Electric Membership Corporation	25,000	36,159,706	1,660,483
Washington-St Tammany Electric Cooperative, Inc	8,700	12,588,725	578,075
Total	93,000	136,110,028	6,217,188
Generation and Transmission Cooperatives			
Arkansas Electric Cooperative Corporation	189,000	406,511,000	14,542,200
Associated Electric Cooperative, Inc	478,000	1,057,633,000	37,175,742
Brazos Electric Power Cooperative, Inc	35,200	34,115,000	2,133,341
Kansas Electric Power Cooperative, Inc	100,000	219,091,000	7,733,936
Northeast Texas Electric Cooperative, Inc	127,500	253,381,000	9,455,117
Rayburn Country Electric Cooperative, Inc	44,125	46,495,642	2,674,516
Sam Rayburn Dam Electric Cooperative, Inc	52,000	25,745,000	3,949,872
Tex-La Electric Cooperative of Texas, Inc	28,175	29,351,358	1,702,546
Western Farmers Electric Cooperative	260,000	547,901,000	19,837,926
Total	1,314,000	2,620,224,000	99,205,196
Joint Action Agencies			
Kansas Municipal Energy Agency ²	9,000	17,755,000	677,646
Louisiana Energy and Power Authority ³	12,900	24,626,000	964,381
Sam Rayburn Municipal Power Agency ⁴	7,350	26,021,180	929,388
Total	29,250	68,402,180	2,571,415
Government Agencies			
Fort Sill Military Reservation, Ft Sill, Oklahoma	36,700	79,826,581	2,831,817
McAlester Army Ammunition Plant, McAlester, Oklahoma	2,688	5,846,699	207,409
Vance Air Force Base, Enid, Oklahoma	5,900	12,626,401	451,621
Total	45,288	98,299,681	3,490,847
SPP Reserve Sharing Companies			
Total	0	977,000	48,147

1 Jefferson Davis deferred the increment of capacity available from the Valley Electric dissolution from June 1, 2012 through May 31, 2013.

2 Served 22 Municipals with Federal Allocations in FY 2012.

3 Served 6 Municipals with Federal Allocations in FY 2012.

4 Has Federal Allocation.

FY 2012 - DETAIL OF BILLINGS TO CUSTOMERS

Municipalities	Capacity (kW)	Energy Delivered (kWh)	Billings for Power Sales (Dollars)
Alexandria, Louisiana	10,700	21,373,000	809,301
Anthony, Kansas	300	588,000	22,558
Augusta, Arkansas	3,700	7,322,000	278,813
Bentonville, Arkansas	18,000	39,657,000	1,394,075
Carthage, Missouri	7,000	14,064,000	649,671
Clarksville, Arkansas	19,100	37,853,000	1,447,840
Clay Center, Kansas	600	1,191,272	45,273
Coffeyville, Kansas	1,900	4,121,000	146,573
Comanche, Oklahoma	4,200	8,090,269	313,470
Copan, Oklahoma	2,500	4,815,637	186,590
Duncan, Oklahoma	32,500	62,603,265	2,425,664
Eldorado, Oklahoma	1,300	2,504,130	97,027
Fulton, Missouri	3,000	5,958,000	226,356
Goltry, Oklahoma	900	1,733,628	67,172
Granite, Oklahoma	2,300	4,430,386	171,662
Hermann, Missouri	5,800	11,502,000	437,619
Higginsville, Missouri	3,000	5,976,000	226,706
Hominy, Oklahoma	10,000	19,262,543	746,358
Jonesboro, Arkansas	80,000	173,804,557	6,610,541
Jonesville, Louisiana	500	778,972	35,664
Kansas City, Kansas	38,600	77,067,000	2,908,130
Kennett, Missouri	11,000	22,573,000	954,056
Lafayette, Louisiana	18,600	31,983,000	1,358,677
Lamar, Missouri	12,000	23,933,000	907,104
Lexington, Oklahoma	4,100	7,897,644	306,007
Malden, Missouri	5,000	10,862,785	432,934
Manitou, Oklahoma	600	1,155,752	44,782
Minden, Louisiana	2,400	4,766,000	181,116
Natchitoches, Louisiana	2,600	5,145,000	195,921
New Madrid, Missouri	4,500	8,899,000	361,789
Nixa, Missouri	5,300	11,066,000	429,384
Olustee, Oklahoma	700	1,348,378	52,245
Paragould, Arkansas	50,500	109,714,128	4,361,125
Paris, Arkansas	10,800	23,691,949	835,664
Piggott, Arkansas	4,900	10,645,533	422,532
Poplar Bluff, Missouri	39,500	85,815,997	3,390,792
Purcell, Oklahoma	14,500	27,930,688	1,082,220
Ruston, Louisiana	4,900	9,295,000	363,532
Ryan, Oklahoma	1,900	3,659,884	141,808
Sikeston, Missouri	33,800	68,210,000	2,915,648
Skiatook, Oklahoma	11,000	24,068,000	850,644
Spiro, Oklahoma	4,000	7,705,017	298,543
Springfield, Missouri	50,000	104,380,000	4,251,143
Thayer, Missouri	2,800	5,481,000	210,066
Walters, Oklahoma	6,400	12,328,027	477,669
West Plains, Missouri	15,000	29,603,000	1,204,868
Wetumka, Oklahoma	2,600	5,008,262	194,053
Winfield, Kansas	1,600	3,176,728	120,729
Yale, Oklahoma	3,700	7,127,140	276,153
Total	570,600	1,172,165,571	45,868,267

1 Includes a significant quantity of off-peak, non-firm energy. Southwestern's composite cost for 1,200 hours of firm capacity and firm peaking energy was \$0.0571/kWh in FY 2012.

Total Capacity (kW) 2,052,138
Total Energy (kWh) 4,096,178,460¹
Total Billings (\$) 157,401,060

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SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Financial Statements

September 30, 2012 and 2011

(With Independent Auditors' Report Thereon)



KPMG LLP
Suite 310
100 West Fifth Street
Tulsa, OK 74103

Independent Auditors' Report

Administrator, Southwestern Power Administration and
The Inspector General, U.S. Department of Energy:

We have audited the accompanying combined balance sheets of the Southwestern Federal Power System (SWFPS), as of September 30, 2012 and 2011, and the related combined statements of changes in capitalization, revenues and expenses, and cash flows for the years then ended. As described in note 1(a), the combined financial statement presentation includes all of the hydroelectric generating and power operations of one Federal agency (hereinafter referred to as the generating agency), and the transmission and disposition of the related power by the Southwestern Power Administration (Southwestern), a separate Federal agency. These combined financial statements are the responsibility of the managements of Southwestern and the generating agency. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Southwestern and the generating agency's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall combined financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to previously present fairly, in all material respects, the respective financial position of the Southwestern Federal Power System, as of September 30, 2012 and 2011, and the results of its operations and its cash flow for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on SWFPS's 2012 and 2011 combined financial statements taken as a whole. The supplementary information in schedules 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic combined financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic combined financial statements taken as a whole.

KPMG LLP

July 1, 2013

KPMG LLP is a Delaware limited liability partnership,
the U.S. member firm of KPMG International Cooperative
("KPMG International"), a Swiss entity.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Balance Sheets

September 30, 2012 and 2011

Assets	2012	2011
Plant in service	\$ 1,461,505,101	1,406,429,371
Accumulated depreciation	(675,046,190)	(650,831,140)
Construction work in progress	187,705,708	188,497,435
Net utility plant	974,164,619	944,095,666
Cash	225,915,198	224,826,826
Funds held in escrow	86,596,550	54,204,016
Accounts receivable	17,641,927	15,274,574
Materials and supplies, at average cost	2,912,428	2,688,809
Banking exchange receivables	4,152,093	3,965,017
Deferred workers' compensation	14,372,940	12,764,665
Other assets	33,291,690	31,224,421
Total assets	<u>\$ 1,359,047,445</u>	<u>1,289,043,994</u>
Liabilities and Capitalization		
Liabilities:		
Accounts payable and accrued liabilities	\$ 14,949,158	14,871,451
Advances for construction	22,632,486	22,742,722
Accrued workers' compensation	15,638,595	13,954,623
Purchased power and banking exchange deferral	39,436,080	54,221,980
Hydropower water storage reallocation deferral	60,513,411	59,711,040
Total liabilities	<u>153,169,730</u>	<u>165,501,816</u>
Capitalization:		
Payable to U.S. Treasury	896,961,854	858,413,041
Accumulated net revenues	308,915,861	265,129,137
Total capitalization	1,205,877,715	1,123,542,178
Commitments and contingencies (notes 5 and 6)		
Total liabilities and capitalization	<u>\$ 1,359,047,445</u>	<u>1,289,043,994</u>

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Statements of Changes in Capitalization

Years ended September 30, 2012 and 2011

	<u>Payable to U.S. Treasury</u>	<u>Accumulated net revenues</u>	<u>Total capitalization</u>
Total capitalization as of September 30, 2010	\$ 887,066,788	243,535,704	1,130,602,492
Additions:			
Congressional appropriations	97,324,419	—	97,324,419
Interest on payable to U.S. Treasury and other	15,426,630	—	15,426,630
Total additions to capitalization	<u>112,751,049</u>	<u>—</u>	<u>112,751,049</u>
Deductions:			
Payments to U.S. Treasury	(140,381,828)	—	(140,381,828)
Transfers of property and services, net	(1,022,968)	—	(1,022,968)
Total deductions to capitalization	<u>(141,404,796)</u>	<u>—</u>	<u>(141,404,796)</u>
Net revenues for the year ended September 30, 2011	<u>—</u>	<u>21,593,433</u>	<u>21,593,433</u>
Total capitalization as of September 30, 2011	<u>858,413,041</u>	<u>265,129,137</u>	<u>1,123,542,178</u>
Additions:			
Congressional appropriations	51,829,037	17,000,000	68,829,037
Interest on payable to U.S. Treasury and other	15,831,486	—	15,831,486
Total additions to capitalization	<u>67,660,523</u>	<u>17,000,000</u>	<u>84,660,523</u>
Deductions:			
Payments to U.S. Treasury	(34,079,302)	—	(34,079,302)
Transfers of property and services, net	4,967,592	—	4,967,592
Total deductions to capitalization	<u>(29,111,710)</u>	<u>—</u>	<u>(29,111,710)</u>
Net revenues for the year ended September 30, 2012	<u>—</u>	<u>26,786,724</u>	<u>26,786,724</u>
Total capitalization as of September 30, 2012	<u>\$ 896,961,854</u>	<u>308,915,861</u>	<u>1,205,877,715</u>

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Statements of Revenues and Expenses

Years ended September 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Sales of electric power	\$ 156,918,798	153,841,907
Transmission and other operating revenues	<u>21,374,645</u>	<u>17,673,345</u>
Total operating revenues before deferrals	178,293,443	171,515,252
Net purchased power and banking exchange deferral	<u>16,659,798</u>	<u>(4,361,377)</u>
Total operating revenues	194,953,241	167,153,875
Non reimbursable revenues	<u>458,141</u>	<u>3,320,398</u>
Total revenues	<u>195,411,382</u>	<u>170,474,273</u>
Operating expenses:		
Operation and maintenance	77,748,200	77,709,646
Purchased power and banking exchange	31,776,926	10,094,337
Depreciation and amortization	28,410,947	30,263,579
Transmission service charges by others	3,083,784	3,078,739
Retirement and other employee benefit expense	7,133,136	7,254,781
Non reimbursable expenses	<u>6,740,628</u>	<u>6,437,955</u>
Total operating expenses	<u>154,893,621</u>	<u>134,839,037</u>
Net operating revenues	<u>40,517,761</u>	<u>35,635,236</u>
Interest expense:		
Interest on payable to U.S. Treasury and other	19,905,550	19,081,977
Allowance for funds used during construction	<u>(6,174,513)</u>	<u>(5,040,174)</u>
Net interest expense	<u>13,731,037</u>	<u>14,041,803</u>
Net revenues	<u>\$ 26,786,724</u>	<u>21,593,433</u>

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combined Statements of Cash Flows

Years ended September 30, 2012 and 2011

	2012	2011
Cash flows from operating activities:		
Net revenues	\$ 26,786,724	21,593,433
Adjustments to reconcile net revenues to net cash provided by operating activities:		
Depreciation and amortization	28,410,947	30,263,579
Benefit expense paid by other Federal agencies	3,536,950	3,717,549
Interest on payable to U.S. Treasury and other	19,862,967	19,630,324
Allowance for funds used during construction	(6,174,513)	(5,040,174)
(Increase) decrease in assets:		
Accounts receivable	(2,367,353)	2,176,909
Materials and supplies	(223,619)	(478,767)
Banking exchange receivables	(187,076)	(472,988)
Deferred workers' compensation	(1,608,275)	2,922,849
Other assets	(2,067,269)	(9,034,666)
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	77,707	5,036,110
Accrued workers' compensation	1,683,972	(2,935,661)
Purchased power and banking exchange deferral	(16,460,039)	4,493,035
Advances for construction	(110,236)	5,784,893
Net cash provided by operating activities	51,160,887	77,656,425
Cash flows from investing activities:		
Additions to utility plant	(52,305,387)	(74,812,273)
Cash flows from financing activities:		
Congressional appropriations	68,829,037	97,324,419
Payments to U.S. Treasury	(34,079,302)	(140,381,828)
Transfers of property and services, net	1,430,642	(4,740,517)
Hydropower water storage reallocation deferral	(1,554,971)	35,651,299
Funds received in escrow	(98,863,373)	(26,596,891)
Funds disbursed from escrow	66,470,839	21,306,531
Net cash provided by (used in) financing activities	2,232,872	(17,436,987)
Net increase (decrease) in cash	1,088,372	(14,592,835)
Cash, beginning of year	224,826,826	239,419,661
Cash, end of year	\$ 225,915,198	224,826,826
Supplemental cash flow information:		
Interest deferred on regulatory liabilities	\$ 4,031,481	4,203,694

See accompanying notes to combined financial statements.

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

(1) Summary of Significant Accounting Policies

(a) General Information and Basis of Preparation of Financial Statements

The Southwestern Federal Power System (SWFPS) financial statements combine all of the activities associated with the production, transmission, and disposition of all Federal power marketed under Section 5 of the Flood Control Act of 1944 (the Flood Control Act) by the Southwestern Power Administration (Southwestern), an agency of the U.S. Department of Energy (DOE). The accompanying combined financial statements include the accounts of Southwestern and the related hydroelectric generating facilities and power operations of the U.S. Army Corps of Engineers (Corps), an agency of the U.S. Department of Defense (DOD). Southwestern and the Corps are separately managed and financed and each maintains their own accounting records. For purposes of financial and operational reporting, the facilities and related operations of Southwestern and the Corps (power purpose) are combined as SWFPS.

The Corps has constructed and operates hydroelectric generating facilities in the states of Arkansas, Missouri, Oklahoma, and Texas. Operating expenses and net assets of multi-purpose Corps projects are allocated to power and nonpower purposes (primarily recreation and flood control). Only the portion of such project costs and net assets allocated to power are included in the combined financial statements. Southwestern, as designated by the Secretary of Energy, transmits and markets power generated from these hydroelectric generating facilities.

The SWFPS is subject to the accounting regulations of the Federal Energy Regulatory Commission (FERC). Accounts are maintained in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) as established by Financial Accounting Standards Board (FASB), the uniform system of accounts prescribed for electric utilities by the FERC, the accounting practices and standards established by the DOE and DOD, and the requirements of specific legislation and executive directives issued by government agencies. SWFPS's combined financial statements follow the accounting and reporting guidance contained in FASB Accounting Standards Codification (ASC) Topic 980, *Regulated Operations*. Allocation of costs and revenues to accounting periods for rate-making and regulatory purposes may differ from bases generally applied by nonregulated companies. Such allocations to meet regulatory accounting requirements are considered to be U.S. GAAP for regulated utilities provided that there is a demonstrable ability to recover any deferred costs in future rates and such costs or revenues are accounted for as regulatory assets or liabilities.

(b) Confirmation and Approval of New Rates

SWFPS is not a public utility within the jurisdiction of FERC under the Federal Power Act. Under a Delegation Order issued by the Secretary of Energy, the Administrator of Southwestern has the authority to develop power and transmission rates for the SWFPS. Such rates are approved on an interim basis by the Deputy Secretary of Energy. FERC has the exclusive authority to confirm, approve, and place into effect on a final basis, to remand, or to disapprove, rates developed by the Administrator.

FERC's review is limited to (1) whether the rates are the lowest possible consistent with sound business principles, (2) whether the revenue levels generated are sufficient to recover the costs of

(Continued)

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

producing and transmitting electric energy including repayment within the period permitted by law, and (3) the assumptions and projections used in developing the rates component. FERC shall reject decisions of the Administrator only if it finds them to be arbitrary, capricious, or in violation of the law.

The rates in effect as of September 30, 2012 are summarized as follows:

The Integrated System rate schedules were placed into effect January 1, 2012 and were confirmed and approved by the FERC on March 5, 2012. These rate schedules incorporated a 5.4% revenue increase and remain in effect through September 30, 2015, or until superseded by new rate schedules.

The Robert D. Willis project rate required no rate action during fiscal year 2012. The Robert D. Willis project rate was approved and confirmed by the FERC on April 27, 2009, for the period October 1, 2008 through September 30, 2012. The Sam Rayburn Dam project rate required no rate action during fiscal year 2012. The Sam Rayburn Dam project rate in effect from January 1, 2009 through September 30, 2012 was confirmed and approved by the FERC on March 30, 2009.

(c) *Utility Plant and Depreciation*

Utility plant includes items such as dams, spillways, generators, turbines, substations and related components (generating facilities), and transmission lines and related components. Utility plant is stated at original cost, net of contributions by external entities. Property transferred from other government agencies is transferred at net book value. Cost includes direct labor and material, payments to contractors, indirect charges for engineering, supervision and similar overhead items, and an allowance for funds used during construction. The costs of additions and betterments are capitalized. Repairs and minor replacements are charged to operation and maintenance expense. Generally, the cost of utility plant retired, together with removal costs less salvage, is charged to accumulated depreciation when the property is removed from service. Gains and losses are recognized only on sales of significant identifiable assets.

The policy of Southwestern and the Corps is to move capitalized costs into completed utility plant at the time a project or feature of a project is deemed to be substantially complete. A project is substantially complete when it is providing benefits and services for the intended purpose, and is generating project purpose revenue, where applicable.

Depreciation on utility plant is computed on a straight-line basis over the estimated service lives of the various classes of property. Service lives currently range from 5 to 100 years for transmission plant and generating facility components.

(d) *Cash and Funds Held in Escrow*

Cash represents the unexpended balance of funds authorized by Congress, customer advances, and spectrum relocation funds, held at the U.S. Department of the Treasury (Treasury). Cash received from the sale of power is generally deposited directly with the Treasury and is reflected as "Payments to U.S. Treasury" in the accompanying combined financial statements. Cash held for customer advances is restricted for the purposes agreed to between Southwestern and the customer.

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SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

Funds held in escrow represents the unexpended balance of funds held in a bank trust account under agreements with certain customers and are restricted specifically to fund operation, maintenance, rehabilitation, and modernization activities at hydroelectric generating facilities of the Corps in SWFPS's marketing region. Under the agreements, funds deposited to the escrow account by customers are credited by Southwestern against accounts receivable for power and energy sold to the customer. The escrowed funds are transferred to the Corps, as needed, to meet contractual obligations as outlined in the agreements. Unused funds held in escrow, if any, will be returned to Southwestern and then to the Treasury upon termination of the agreements.

(e) *Congressional Appropriations*

Southwestern and the Corps receive congressional appropriations through DOE and DOD, respectively, to finance their operations. Certain of Southwestern's appropriations are offset by the use of receipts collected from the sale of Federal hydroelectric power, resulting in a net zero appropriation. The Corps also receives appropriations to finance construction of its hydroelectric projects. In accordance with the Flood Control Act, Southwestern is responsible for repayment to the Federal government, with interest, of its appropriations, and the portion of congressional appropriations allocated to the Corps for construction and operations of the power projects.

Congressional appropriations received by the Corps are authorized and allocated to individual projects. It is the intent of the Corps' project management to distribute congressional appropriations in amounts approximating estimated current year expenses and to adjust the distribution as necessary within the limits of the transfer authority residing at the district level. Project costs that are not specific to a project purpose are distributed between power and nonpower purposes based on project cost allocation.

(f) *Purchased Power and Banking Exchange Deferral and Receivable*

SWFPS utilizes a separate rate component (purchased power adder) to recover the estimated cost of purchased power based upon the average purchased power costs expected to occur in the future. If the actual expenses of purchased power exceed the revenue generated from this adder, the cost is deferred for future recovery through rates. Likewise, if the expense is less than the adder, the excess revenue is deferred. From time to time, SWFPS may utilize a separate rate component (adder adjustment) to manage additional purchased power expenses or excess revenues, respectively.

SWFPS has arrangements with certain customers in which excess power available on the power system is banked with the customer until needed by the power system and the customer has power available. The power system records a receivable for the power banked at the cost specified in the marketing arrangement, under the provisions of FASB ASC Topic 845, *Nonmonetary Transactions*. The net revenue or expense associated with banking activity is deferred until the power is returned or delivered.

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SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

(g) *Operating Revenues*

Operating revenues are recorded on the basis of service rendered. Rates are established under requirements of the Flood Control Act, related legislation and executive departmental directives, and are to provide sufficient revenues to meet all required repayment of system costs, including operation and maintenance expenses less depreciation, interest, and payment to the U.S. Treasury for the Payable to U.S. Treasury in utility plant. Rates are intended to provide for recovery of the Payable to U.S. Treasury in transmission and generating facilities not to exceed 50 years from the date placed in service, while operation and maintenance costs and interest on Payable to U.S. Treasury are intended to be recovered annually.

As set forth in "Utility Plant and Depreciation" above, assets are being depreciated for financial reporting purposes using the straight-line method over their estimated service lives, which currently range from 5 to 100 years for transmission and generating facility components. Accordingly, annual depreciation charges are not matched with the recovery of the related capital costs and will, in the case of generating facilities, continue beyond the period within which such costs will have been recovered through rates.

While energy and transmission rates are established to recover the costs of operating the power projects, rates are also required to be at the lowest possible level, consistent with sound business principles. Over the life of the power system, accumulated net revenues represent differences between the timing of the recognition of expenses and related revenues, resulting primarily from the difference between the recognition of depreciation and the related recovery of the U.S. Treasury's investment in utility plant. SWFPS is a Federal entity, thus at any given time the accumulated net revenues, to the extent available, are committed to the repayment of the Payable to U.S. Treasury.

The practices followed by Southwestern and the Corps are in conformity with the accounting practices and standards established by DOE and DOD and the requirements of specific legislation and executive directives issued by government agencies. Based upon guidelines established in DOE Order RA 6120.2, revenues distributed to the Corps cover annual operating expenses including interest, with the remainder applied to the unpaid generation investment.

(h) *Regulatory Assets*

Regulatory assets are assets that result from rate actions of Southwestern's Administrator and other regulatory agencies. These assets arise from specific costs that would have been included in the determination of net revenue in one period, but are deferred until a different period for purposes of developing rates to charge for services, per the requirements of ASC Topic 980. SWFPS defers costs as regulatory assets so that the costs will be recovered through the rates during the periods when the costs are scheduled to be repaid. This ensures the matching of revenues and expenses. SWFPS does not earn a rate of return on its regulatory assets.

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SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

(i) *Accounts Receivable*

SWFPS's accounts receivable consist generally of receivables for power and energy sold to its customers who are primarily public bodies and cooperatives. SWFPS provides for uncollectible accounts if collection is in doubt. No allowance for uncollectible accounts was considered necessary for any year presented herein.

Billing methods used by Southwestern include net billing and bill crediting. Net billing is an agreement between Southwestern and a customer, whereby the customer's power invoice is credited and the funds received from the sale of power are used to fund transmission and generation activities. Net billing is discussed more fully in note 4(b). Bill crediting involves a billing arrangement among Southwestern, a customer, and a third party, whereby the customer's power invoice is credited and the customer pays a third party for goods or services received by Southwestern. Under Southwestern billing methods, purchase and sale transactions are reported "gross" in the combined financial statements.

(j) *Concentration of Credit Risk*

Financial instruments, which potentially subject SWFPS to credit risk, include accounts receivable for customer purchases of power, transmission, or other products and services. These receivables are primarily with a group of diverse customers that are generally stable, and established organizations, which do not represent a significant credit risk. Although SWFPS is affected by the business environment of the utility industry, management does not believe a significant risk of loss from a concentration of credit exists.

(k) *Interest on Payable to U.S. Treasury*

Interest on Payable to U.S. Treasury is a cost mandated by the Secretary of Energy and by the FERC. SWFPS computes interest in accordance with DOE Order RA 6120.2, which provides that interest be computed on the remaining investment after revenues have been applied to recovery of costs during the year, any prior year unpaid costs, and then to Federal investment bearing the highest interest rate.

(l) *Allowance for Funds Used During Construction*

The FERC Uniform System of Accounts defines Allowance for Funds Used During Construction as the net costs for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used. While cash is not realized currently from this allowance, it is realized under the rate-making process over the repayment life of the related property through increased revenues resulting from a higher recoverable investment. The interest rates used are established by law, administrative order, or administrative policy for the fiscal year during which the construction commenced (4.000% for fiscal year 2012 and 4.125% for fiscal year 2011).

(m) *Retirement Benefits*

SWFPS employees participate in one of the following contributory defined benefit plans: the Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS). Agency contributions are based on eligible employee compensation and are submitted to benefit program trust funds administered by the Office of Personnel Management (OPM). Based on statutory

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SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

contribution rates, the fiscal years 2012 and 2011 cost factors under CSRS were 29.8% and 30.1%, respectively, of basic pay. The cost factors under FERS for fiscal years 2012 and 2011 were 13.7% and 13.8%, respectively, of basic pay. The contribution levels, however, are legislatively mandated and do not reflect the current full cost requirements to fund the plans. Costs incurred by OPM on behalf of SWFPS are included as transfers of property and services, net within the Payable to U.S. Treasury on the combined balance sheets.

Other retirement benefits administered by the OPM include the Federal Employees Health Benefits Program (FEHB) and the Federal Employees Group Life Insurance Program (FEGLI). FEHB is calculated at \$5,817 and \$6,027, per enrolled employee, for fiscal years 2012 and 2011, respectively, and FEGLI is based on 0.02% of basic pay for each employee enrolled in these programs.

In addition to the amounts contributed to the CSRS and FERS as stated above, SWFPS recorded an expense and related liability for the pension and other postretirement benefits in the combined financial statements of \$3,536,950 and \$3,717,549 for the years ended September 30, 2012 and 2011, respectively. These amounts reflect the contributions made on behalf of SWFPS by OPM to the benefit program trust funds.

As a Federal agency, all post-retirement activity is managed by OPM, therefore, neither the assets of the plans nor the actuarial data with respect to the accumulated plan benefits relative to Southwestern and the Corps employees are included in this report.

(n) *Workers' Compensation*

Workers' compensation consists of two elements: actuarial liability associated with workers' compensation cases incurred for which additional claims may still be made in the future (future claims) and a liability for expenses associated with actual claims incurred and paid by the Department of Labor (DOL), the program administrator, whom SWFPS must reimburse. DOL, DOE, and DOD determined Southwestern and the Corps actuarial liability associated with workers' compensation cases. The actuarial liability for future claims was determined using historical benefit payment patterns and the Treasury discount rates.

The recovery of these future claims will be deferred for purposes of the rate-making process until such time as the future claims are actually submitted and paid by the DOL. Therefore, the recognition of the expense associated with this actuarially determined liability has been recorded as deferred workers' compensation in the combined balance sheets in accordance with ASC Topic 980 to reflect the effects of the rate-making process.

(o) *Transfers of Property and Services, Net*

Transfers of property and services, net is a component of total capitalization that represents the cumulative receipt of transfers of assets or costs offset by the cumulative disbursement of transfers of revenues. Transfers are recognized upon physical delivery of the asset or performance of the service. Transfers occur between projects, project types, and other Federal entities. Transfers between Southwestern and the generating agency eliminate upon consolidation.

(Continued)

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

(p) *Income Taxes*

As agencies of the U.S. Government, Southwestern and the Corps are exempt from all income taxes imposed by any governing body, whether it is a Federal, state, or commonwealth of the United States.

(q) *Use of Estimates*

The preparation of the combined financial statements in conformity with U.S. GAAP requires management of SWFPS to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the useful lives of completed utility plant, allowances for doubtful accounts, employee benefit obligations, and other contingencies. Actual results could differ from those estimates.

(r) *Denison Hydropower Water Storage Reallocation*

Section 838 of P.L. 99-662 (Section 838) authorized the Corps to reallocate hydropower storage to water supply storage at Lake Texoma, in increments as needed, up to 150,000 acre-feet for users in the State of Texas and up to 150,000 acre-feet for users in the State of Oklahoma. Section 838 directed that the Corps would provide credits to Southwestern equal to the replacement cost of the hydropower lost as a result of the reallocations, and Southwestern would reimburse the preference customers (Denison allottees) for an amount equal to the customers' replacement cost of the hydropower lost as a result of the reallocations.

In fiscal year 2010, the Corps executed water supply contracts for the 150,000 acre-feet of storage authorized for customers in the State of Texas by Section 838. According to a June 2010 agreement between Southwestern and the Corps, the Corps agreed to deposit all cost of storage payments for storage reallocated under Section 838 into the U.S. Treasury and to provide credits in the same amount to the hydropower income account. In fiscal year 2011, the Corps received \$37,174,287 in payments for the reallocated water supply storage and credited the total amount to Southwestern. The Corps did not receive any payments in fiscal year 2012. The total amount received of \$58,786,011 was deferred by Southwestern for the provision of the reimbursement to the Denison allottees and Southwestern for future hydropower storage revenues foregone.

A September 2010 agreement between Southwestern and the Denison allottees provided the initial hydropower replacement cost as determined by Southwestern and the methodology for providing the reimbursement to the Denison allottees as authorized under Section 838. Beginning with the invoice for the October 2010 service month, reimbursement pursuant to Section 838 began as a credit on the Denison allottees' monthly invoices.

(Continued)

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

(s) Non Reimbursable Activities

Non reimbursable activity for the years ended September 30, 2012 and 2011 consists of the following:

	<u>2012</u>	<u>2011</u>
Non reimbursable revenues:		
Non Federal project revenue	\$ 378,392	1,099,209
Federal project revenue	(943)	1,974,964
Interest revenue	80,692	246,225
Total non reimbursable revenues	<u>\$ 458,141</u>	<u>3,320,398</u>
Non reimbursable expenses:		
Non Federal project expense	\$ 378,392	1,099,209
Federal project expense	(943)	1,974,964
White River Minimum Flows expense	3,532,827	1,992,124
Spectrum Relocation Fund expense	2,803,865	1,321,658
Other project expense	26,487	50,000
Total non reimbursable expenses	<u>\$ 6,740,628</u>	<u>6,437,955</u>

Federal and Non Federal Projects

Southwestern has agreements with Federal and non Federal entities to provide services on a cost basis. Non Federal entities are required to provide advance payment for Southwestern's services. The operating revenues and expenses related to these services are excluded from the rate-making process. A portion of cash and advances from construction in the accompanying combined financial statements relate to these activities.

Escrow Interest Revenue

Interest revenue represents the interest earned on funds held in escrow. These funds are authorized specifically to fund operation, maintenance, rehabilitation, and modernization activities at hydroelectric generating facilities of the Corps in SWFPS's marketing region. This activity is non reimbursable through the rate-making process.

White River Minimum Flows Project

In accordance with Section 132 of P.L. 109-103, Southwestern implemented the minimum flows project in fiscal year 2010. Section 132 provided that losses to Federal hydropower shall be offset by a reduction in the costs allocated to the Federal hydropower purpose. Southwestern determined the Federal hydropower impacts to include lost on-peak energy and capacity, lost off-peak energy, increased costs due to dissolved oxygen impacts, and increased maintenance costs at Bull Shoals. This activity is non reimbursable through the rate-making process.

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SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

Spectrum Relocation Fund

In December 2004, the U.S. Congress passed and the President signed the Commercial Spectrum Enhancement Act (CSEA, Title II of P.L. 108-494), creating the Spectrum Relocation Fund (SRF) to streamline the relocation of Federal systems from existing spectrum bands to accommodate commercial use by facilitating reimbursement to affected agencies of relocation costs. In fiscal years 2012, 2009, and 2007, Southwestern received \$17,000,000, \$17,730,000, and \$8,091,360, respectively, in spectrum relocation funds, as approved by the Office of Management and Budget, and as reported to the Congress. In fiscal years 2012 and 2011, Southwestern expensed \$2,803,865 and \$1,321,658, respectively. Expenses incurred represent labor, service contracts, travel, and other administrative costs. This activity is non reimbursable through the rate-making process.

(t) *Derivative and Hedging Activities*

Southwestern analyzes derivative financial instruments under FASB ASC Topic 815, *Derivatives and Hedging*. This standard requires that all derivative instruments, as defined by ASC Topic 815, be recorded on the combined balance sheets at fair value, unless exempted. Changes in a derivative instrument's fair value must be recognized currently in the combined statement of revenues and expenses, unless the derivative has been designated in a qualifying hedging relationship. The application of hedge accounting allows a derivative instrument's gains and losses to offset related results of the hedged item in the combined statements of revenues and expenses to the extent effective. ASC Topic 815 requires that the hedging relationship be highly effective and that an organization formally designate a hedging relationship at the inception of the contract to apply hedge accounting.

Southwestern enters into contracts for the sale of electricity for use in its business operations. ASC Topic 815 requires Southwestern to evaluate these contracts to determine whether the contracts are derivatives. Certain contracts that literally meet the definition of a derivative may be exempted from ASC Topic 815 as normal purchases or normal sales. Normal purchases and sales are contracts that provide for the purchase or sale of something other than a financial instrument or derivative instrument that will be delivered in quantities expected to be used or sold over a reasonable period of time in the normal course of business. Contracts that meet the requirements of normal purchases or sales are documented and exempted from the accounting and reporting requirements of ASC Topic 815.

Southwestern's policy is to fulfill all derivative and hedging contracts by providing power to a third party as provided for in each contract. Southwestern's policy does not authorize the use of derivative or hedging instruments for speculative purposes such as hedging electricity pricing fluctuations beyond Southwestern's estimated capacity to deliver power. Accordingly, Southwestern evaluates all of its contracts to determine if they are derivatives and, if applicable, to ensure that they qualify and meet the normal purchases and normal sales designation requirements under ASC Topic 815. Normal sales contracts are accounted for as executory contracts as required under U.S. GAAP. As of September 30, 2012 and 2011, Southwestern has no contracts accounted for as derivatives.

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SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

(u) Fair Value of Financial Instruments

FASB ASC Topic 825, *Financial Instruments*, requires disclosure of the fair value of financial instruments. The carrying (recorded) value of short-term financial instruments, including cash, funds held in escrow, accounts receivable, accounts payable and accrued liabilities, and advances for construction, approximates the fair value of these instruments. The fair value of certain unfunded and actuarially based liabilities cannot be determined as the future payout dates have yet to be determined.

(2) Utility Plant

Utility plant as of September 30, 2012 and 2011 consists of the following:

	2012	2011
Plant in service:		
Generating facilities	\$ 1,139,425,949	1,096,795,371
Transmission facilities	322,079,152	309,634,000
	<u>1,461,505,101</u>	<u>1,406,429,371</u>
Less accumulated depreciation	<u>(675,046,190)</u>	<u>(650,831,140)</u>
Construction work in progress:		
Generating facilities	160,473,827	167,926,381
Transmission facilities	27,231,881	20,571,054
	<u>187,705,708</u>	<u>188,497,435</u>
Net utility plant	<u>\$ 974,164,619</u>	<u>944,095,666</u>

In accordance with FERC guidelines, SWFPS excludes contributed plant within the combined balance sheets to eliminate the impact on power rates. As of September 30, 2012 and 2011, contributed plant, net used in SWFPS's operations totaled \$16,946,019.

(3) Regulatory Assets and Liabilities

Regulatory assets and liabilities as of September 30, 2012 and 2011 consists of the following:

	2012	2011
Regulatory assets:		
Deferred workers' compensation	\$ 14,372,940	12,764,665
Regulatory liabilities:		
Hydropower water storage reallocation deferral	\$ 60,513,411	59,711,040
Purchased power and banking exchange deferral	39,436,080	54,221,980
Total	<u>\$ 99,949,491</u>	<u>113,933,020</u>

(Continued)

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

The deferred workers' compensation represents a regulatory asset that will be expensed as future claims are actually submitted and paid by the DOL (see note 1 (n)).

Southwestern's purchased power and banking exchange deferral account represents the deferral of net revenue or expenses associated with net purchased power and banking exchange activities as follows:

	Purchased power and banking exchange deferral
September 30, 2010	\$ (47,832,866)
Purchased power adder revenue	(14,918,065)
Purchased power expense	10,815,520
Net banking exchange	(258,832)
Net purchased power and banking exchange deferral	(4,361,377)
Interest on deferred activities and other	(2,027,737)
September 30, 2011	(54,221,980)
Purchased power adder revenue	(11,961,869)
Purchased power expense	28,635,408
Net banking exchange	(13,742)
Net purchased power and banking exchange deferral	16,659,797
Interest on deferred activities and other	(1,873,897)
September 30, 2012	\$ (39,436,080)

(4) Financing Sources

SWFPS's financing sources include annual appropriations, Federal power receipts (Use of Receipts), and alternative financing arrangements to fund its operations.

(a) Payable to U.S. Treasury

Construction and operation of Southwestern's transmission system and the Corps' generating facilities and operations are financed through congressional appropriations. The exceptions are capital assets and maintenance activities funded through the alternative financing arrangements and the funding by non-Federal parties of the construction of the Robert Douglas Willis project. The U.S. Government's investment in each generating project and each year's investment in the transmission system is to be repaid to the Treasury over a period not to exceed 50 years from the time the facility is placed in service. There is no requirement for repayment of a specific amount on an annual basis.

Revenues received from the sale of Federal power and purchased power are generally deposited with the Treasury. Annual revenues are first applied to the current year operating expenses (less

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SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

depreciation) and interest expense. All annual amounts for such expenses have been paid through fiscal year 2012. Remaining revenues are to be first applied to repayment of operating deficits (which include all expenses except depreciation), if any, and then to repayment of the Payable to U.S. Treasury. To the extent possible, while still complying with the repayment period established for each increment of investment and unless otherwise required by legislation, repayment of the investment is to be accomplished by a repayment of the highest interest-bearing investment first. Interest rates applied to the unamortized initial investment of the U.S. Government in the Corps' hydroelectric generating facilities range from 2.50% to 5.75% for unpaid facilities in service prior to fiscal year 2012 and 4% for facilities placed in service during fiscal year 2012. The rates have been set by law, by administrative order pursuant to law, or by administrative policies using the U.S. Senate Document No. 97 formula for the fiscal year during which the appropriations were requested.

(b) *Alternative Financing*

Due to fluctuations in the amount of annual appropriations received to fund operations, maintenance, rehabilitation, and modernization of the SWFPS facilities, SWFPS has established an alternative financing program under reimbursable authority regulations. Under agreements with customers to finance projects, which benefit the SWFPS, funds received from the sale of power are net billed, allowing a portion of the funds to be utilized to finance agreed-upon projects rather than returned to the Treasury. Under the agreements with certain customers, alternative financing restricted specifically to fund operation, maintenance, rehabilitation, and modernization activities at the hydroelectric generating facilities are held in escrow. All other alternative financing arrangements are collected by Southwestern and deposited as cash held by the Treasury, and are reflected as other assets with an offsetting liability included in advances for construction, until completion of the project at which time the asset and liability are eliminated.

(5) *Commitments and Contingencies*

(a) *General*

Based on the 2012 Integrated System Power Repayment Study prepared as of September 30, 2012, the projected increase in capital investment in 2012 is \$181,151,969, which includes \$19,389,021 for transmission facilities and \$161,762,948 for generating facilities. The five-year investment increase projected in the 2012 Integrated System Power Repayment Study for fiscal years 2012 through 2016 is estimated to cost \$718,901,325.

Southwestern sells the majority of its marketable power to customers under long-term power sales contracts of 15 years, which require Southwestern to provide 1,200 kilowatt hours per kilowatt of peaking contract demand per year, subject to scheduling constraints outlined in each customer's contract. If sufficient power is unavailable to Southwestern from Corps hydroelectric facilities to meet these commitments, Southwestern may be required to purchase power from other sources to meet these commitments. The cost to purchase such power is recovered through the purchased power adder discussed more fully in note 1(f).

(Continued)

SOUTHWESTERN FEDERAL POWER SYSTEM

Notes to Combined Financial Statements

September 30, 2012 and 2011

(b) Legal

SWFPS has exposure to certain claims and legal actions arising in the ordinary course of business. In management's opinion, any resulting actions will not have a material adverse effect on the financial condition or results of operations of SWFPS as of September 30, 2012 and 2011.

(6) Leases

SWFPS is obligated under a 10-year operating lease for office space. This lease consists of a five-year firm term for the first five years and the option to terminate during the second five-year term. This lease commenced January 1, 2004 and is scheduled to terminate December 31, 2013. Future minimum lease payments as of September 30, 2012 are as follows:

Year ending September 30:		
2013	\$	680,000
2014		<u>178,000</u>
Total future minimum lease payments	\$	<u><u>858,000</u></u>

Rent expense for operating leases during the years ended September 30, 2012 and 2011 was \$713,000 and \$692,000, respectively.

(7) Subsequent Events

On October 15, 2012, the Deputy Secretary of Energy approved on an interim basis a change to the Robert D. Willis rate schedules and the new rate schedules incorporated a 15.4% increase. The rates were placed into effect October 1, 2012 and will remain in effect through September 30, 2016.

The Sam Rayburn project rate required a rate extension of the current rate as that rate expired on September 30, 2012. The current rate in effect from January 1, 2009 through September 30, 2012 was extended through September 30, 2013 as confirmed and approved on an interim basis by the Deputy Secretary of Energy on November 7, 2012.

SWFPS has evaluated subsequent events from the balance sheet date through July 1, 2013, the date at which the combined financial statements were available to be issued, and such events are disclosed in these accompanying notes.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Balance Sheet Data

September 30, 2012

Assets	Southwestern	Corps	Total
Plant in service	\$ 322,079,152	1,139,425,949	1,461,505,101
Accumulated depreciation	(159,120,296)	(515,925,894)	(675,046,190)
Construction work in progress	27,231,881	160,473,827	187,705,708
Net utility plant	190,190,737	783,973,882	974,164,619
Cash	98,740,474	127,174,724	225,915,198
Funds held in escrow	18,559,960	68,036,590	86,596,550
Accounts receivable	17,530,560	111,367	17,641,927
Materials and supplies, at average cost	2,887,797	24,631	2,912,428
Banking exchange receivables	4,152,093	—	4,152,093
Deferred workers' compensation	3,806,422	10,566,518	14,372,940
Other assets	33,291,690	—	33,291,690
Total assets	\$ 369,159,733	989,887,712	1,359,047,445
Liabilities and Capitalization			
Liabilities:			
Accounts payable and accrued liabilities	\$ 9,332,612	5,616,546	14,949,158
Advances for construction	22,632,486	—	22,632,486
Accrued workers' compensation	4,793,829	10,844,766	15,638,595
Purchased power and banking exchange deferral	39,436,080	—	39,436,080
Hydropower water storage reallocation deferral	60,513,411	—	60,513,411
Total liabilities	136,708,418	16,461,312	153,169,730
Capitalization:			
Payable to U.S. Treasury	138,839,113	758,122,741	896,961,854
Accumulated net revenues	93,612,202	215,303,659	308,915,861
Total capitalization	232,451,315	973,426,400	1,205,877,715
Commitments and contingencies (notes 5 and 6)			
Total liabilities and capitalization	\$ 369,159,733	989,887,712	1,359,047,445

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Balance Sheet Data

September 30, 2011

Assets	Southwestern	Corps	Total
Plant in service	\$ 309,634,000	1,096,795,371	1,406,429,371
Accumulated depreciation	(150,584,367)	(500,246,773)	(650,831,140)
Construction work in progress	20,571,054	167,926,381	188,497,435
Net utility plant	179,620,687	764,474,979	944,095,666
Cash	72,723,700	152,103,126	224,826,826
Funds held in escrow	27,687,926	26,516,090	54,204,016
Accounts receivable	15,069,679	204,895	15,274,574
Materials and supplies, at average cost	2,664,178	24,631	2,688,809
Banking exchange receivables	3,965,017	—	3,965,017
Deferred workers' compensation	4,712,667	8,051,998	12,764,665
Other assets	31,224,421	—	31,224,421
Total assets	<u>\$ 337,668,275</u>	<u>951,375,719</u>	<u>1,289,043,994</u>
Liabilities and Capitalization			
Liabilities:			
Accounts payable and accrued liabilities	\$ 6,720,305	8,151,146	14,871,451
Advances for construction	22,742,722	—	22,742,722
Accrued workers' compensation	5,690,186	8,264,437	13,954,623
Purchased power and banking exchange deferral	54,221,980	—	54,221,980
Hydropower water storage reallocation deferral	59,711,040	—	59,711,040
Total liabilities	<u>149,086,233</u>	<u>16,415,583</u>	<u>165,501,816</u>
Capitalization:			
Payable to U.S. Treasury	107,130,923	751,282,118	858,413,041
Accumulated net revenues	81,451,119	183,678,018	265,129,137
Total capitalization	<u>188,582,042</u>	<u>934,960,136</u>	<u>1,123,542,178</u>
Commitments and contingencies (notes 5 and 6)			
Total liabilities and capitalization	<u>\$ 337,668,275</u>	<u>951,375,719</u>	<u>1,289,043,994</u>

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Changes in Capitalization Data
Years ended September 30, 2012 and 2011

	Southwestern		Corps		Total
	Payable to U.S. Treasury	Accumulated net revenues (deficit)	Payable to U.S. Treasury	Accumulated net revenues (deficit)	capitalization
Total capitalization as of September 30, 2010	\$ 143,611,177	81,295,933	743,455,611	162,239,771	1,130,602,492
Additions:					
Congressional appropriations	13,049,848	—	84,274,571	—	97,324,419
Interest on payable to U.S. Treasury and other	501,686	—	14,924,944	—	15,426,630
Total additions to capitalization	13,551,534	—	99,199,515	—	112,751,049
Deductions:					
Payments to U.S. Treasury	(29,473,838)	—	(110,907,990)	—	(140,381,828)
Transfers of property and services, net	(20,557,950)	—	19,534,982	—	(1,022,968)
Total deductions to capitalization	(50,031,788)	—	(91,373,008)	—	(141,404,796)
Net revenues for the year ended September 30, 2011	—	155,186	—	21,438,247	21,593,433
Total capitalization as of September 30, 2011	107,130,923	81,451,119	751,282,118	183,678,018	1,123,542,178
Additions:					
Congressional appropriations	11,892,000	17,000,000	39,937,037	—	68,829,037
Interest on payable to U.S. Treasury and other	816,696	—	15,014,790	—	15,831,486
Total additions to capitalization	12,708,696	17,000,000	54,951,827	—	84,660,523
Deductions:					
Payments to U.S. Treasury	76,501,295	—	(110,580,597)	—	(34,079,302)
Transfers of property and services, net	(57,501,800)	—	62,469,392	—	4,967,592
Total deductions to capitalization	18,999,495	—	(48,111,205)	—	(29,111,710)
Net revenues for the year ended September 30, 2012	—	(4,838,917)	—	31,625,641	26,786,724
Total capitalization as of September 30, 2012	\$ 138,839,114	93,612,202	758,122,740	215,303,659	1,205,877,715

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Revenues and Expenses Data

Year ended September 30, 2012

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Operating revenues:			
Sales of electric power	\$ 156,918,798	—	156,918,798
Transmission and other operating revenues	19,595,140	1,779,505	21,374,645
Total operating revenues before deferrals	176,513,938	1,779,505	178,293,443
Net purchased power and banking exchange deferral	16,659,798	—	16,659,798
Revenue distributed to Corps	(109,160,897)	109,160,897	—
Total operating revenues	84,012,839	110,940,402	194,953,241
Non reimbursable revenues	437,641	20,500	458,141
Total revenues	<u>84,450,480</u>	<u>110,960,902</u>	<u>195,411,382</u>
Operating expenses:			
Operation and maintenance	27,108,183	50,640,017	77,748,200
Purchased power and banking exchange	31,776,926	—	31,776,926
Depreciation and amortization	12,654,139	15,756,808	28,410,947
Transmission service charges by others	3,083,784	—	3,083,784
Retirement and other employee benefit expense	4,733,706	2,399,430	7,133,136
Non reimbursable expenses	6,740,628	—	6,740,628
Total operating expenses	<u>86,097,366</u>	<u>68,796,255</u>	<u>154,893,621</u>
Net operating revenues (deficit)	<u>(1,646,886)</u>	<u>42,164,647</u>	<u>40,517,761</u>
Interest expense:			
Interest on payable to U.S. Treasury and other	4,901,811	15,003,739	19,905,550
Allowance for funds used during construction	(1,709,780)	(4,464,733)	(6,174,513)
Net interest expense	<u>3,192,031</u>	<u>10,539,006</u>	<u>13,731,037</u>
Net revenues (deficit)	<u>\$ (4,838,917)</u>	<u>31,625,641</u>	<u>26,786,724</u>

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Revenues and Expenses Data

Year ended September 30, 2011

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Operating revenues:			
Sales of electric power	\$ 153,841,907	—	153,841,907
Transmission and other operating revenues	15,842,893	1,830,452	17,673,345
Total operating revenues before deferrals	169,684,800	1,830,452	171,515,252
Net purchased power and banking exchange deferral	(4,361,377)	—	(4,361,377)
Revenue distributed to Corps	(101,312,538)	101,312,538	—
Total operating revenues	64,010,885	103,142,990	167,153,875
Non reimbursable revenues	3,306,895	13,503	3,320,398
Total revenues	<u>67,317,780</u>	<u>103,156,493</u>	<u>170,474,273</u>
Operating expenses:			
Operation and maintenance	26,771,360	50,938,286	77,709,646
Purchased power and banking exchange	10,094,337	—	10,094,337
Depreciation and amortization	12,591,664	17,671,915	30,263,579
Transmission service charges by others	3,078,739	—	3,078,739
Retirement and other employee benefit expense	4,902,723	2,352,058	7,254,781
Non reimbursable expenses	6,437,955	—	6,437,955
Total operating expenses	<u>63,876,778</u>	<u>70,962,259</u>	<u>134,839,037</u>
Net operating revenues	<u>3,441,002</u>	<u>32,194,234</u>	<u>35,635,236</u>
Interest expense:			
Interest on payable to U.S. Treasury and other	4,703,762	14,378,215	19,081,977
Allowance for funds used during construction	(1,417,946)	(3,622,228)	(5,040,174)
Net interest expense	<u>3,285,816</u>	<u>10,755,987</u>	<u>14,041,803</u>
Net revenues	<u>\$ 155,186</u>	<u>21,438,247</u>	<u>21,593,433</u>

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Cash Flows Data

Year ended September 30, 2012

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Cash flows from operating activities:			
Net revenues (deficit)	\$ (4,838,917)	31,625,641	26,786,724
Adjustments to reconcile net revenues (deficit) to net cash provided by (used in) operating activities:			
Revenue distributed to Corps	109,160,897	(109,160,897)	—
Depreciation and amortization	12,654,139	15,756,808	28,410,947
Benefit expense paid by other Federal agencies	1,415,768	2,121,182	3,536,950
Interest on payable to U.S. Treasury and other	4,848,177	15,014,790	19,862,967
Allowance for funds used during construction	(1,709,780)	(4,464,733)	(6,174,513)
(Increase) decrease in assets:			
Accounts receivable	(2,460,881)	93,528	(2,367,353)
Materials and supplies	(223,619)	—	(223,619)
Banking exchange receivables	(187,076)	—	(187,076)
Deferred workers' compensation	906,245	(2,514,520)	(1,608,275)
Other assets	(2,067,269)	—	(2,067,269)
Increase (decrease) in liabilities:			
Accounts payable and accrued liabilities	2,612,307	(2,534,600)	77,707
Accrued workers' compensation	(896,357)	2,580,329	1,683,972
Purchased power and banking exchange deferral	(16,460,039)	—	(16,460,039)
Advances for construction	(110,236)	—	(110,236)
Net cash provided by (used in) operating activities	<u>102,643,359</u>	<u>(51,482,472)</u>	<u>51,160,887</u>
Cash flows from investing activities:			
Additions to utility plant	<u>(21,514,409)</u>	<u>(30,790,978)</u>	<u>(52,305,387)</u>
Cash flows from financing activities:			
Congressional appropriations	28,892,000	39,937,037	68,829,037
Payments to U.S. Treasury	(32,659,602)	(1,419,700)	(34,079,302)
Transfers of property and services, net	(58,917,568)	60,348,210	1,430,642
Hydropower water storage reallocation deferral	(1,554,971)	—	(1,554,971)
Funds received in escrow	(50,547,873)	(48,315,500)	(98,863,373)
Funds disbursed from escrow	<u>59,675,839</u>	<u>6,795,000</u>	<u>66,470,839</u>
Net cash (used in) provided by financing activities	<u>(55,112,175)</u>	<u>57,345,047</u>	<u>2,232,872</u>
Net increase (decrease) in cash	26,016,775	(24,928,403)	1,088,372
Cash, beginning of year	<u>72,723,700</u>	<u>152,103,126</u>	<u>224,826,826</u>
Cash, end of year	<u>\$ 98,740,475</u>	<u>127,174,723</u>	<u>225,915,198</u>
Supplemental cash flow information:			
Interest deferred on regulatory liabilities	\$ 4,031,481	—	4,031,481

See accompanying independent auditors' report.

SOUTHWESTERN FEDERAL POWER SYSTEM

Combining Schedule of Cash Flows Data

Year ended September 30, 2011

	<u>Southwestern</u>	<u>Corps</u>	<u>Total</u>
Cash flows from operating activities:			
Net revenues	\$ 155,186	21,438,247	21,593,433
Adjustments to reconcile net revenues to net cash provided by (used in) operating activities:			
Revenue distributed to Corps	101,312,538	(101,312,538)	—
Depreciation and amortization	12,591,664	17,671,915	30,263,579
Benefit expense paid by other Federal agencies	1,577,930	2,139,619	3,717,549
Interest on payable to U.S. Treasury and other	4,705,380	14,924,944	19,630,324
Allowance for funds used during construction	(1,417,946)	(3,622,228)	(5,040,174)
(Increase) decrease in assets:			
Accounts receivable	2,301,968	(125,059)	2,176,909
Materials and supplies	(454,136)	(24,631)	(478,767)
Banking exchange receivables	(472,988)	—	(472,988)
Deferred workers' compensation	(914,665)	3,837,514	2,922,849
Other assets	(9,034,666)	—	(9,034,666)
Increase (decrease) in liabilities:			
Accounts payable and accrued liabilities	568,407	4,467,703	5,036,110
Accrued workers' compensation	1,005,528	(3,941,189)	(2,935,661)
Purchased power and banking exchange deferral	4,493,035	—	4,493,035
Advances for construction	5,784,893	—	5,784,893
Net cash provided by (used in) operating activities	<u>122,202,128</u>	<u>(44,545,703)</u>	<u>77,656,425</u>
Cash flows from investing activities:			
Additions to utility plant	<u>(14,534,251)</u>	<u>(60,278,022)</u>	<u>(74,812,273)</u>
Cash flows from financing activities:			
Congressional appropriations	13,049,848	84,274,571	97,324,419
Payments to U.S. Treasury	(130,786,376)	(9,595,452)	(140,381,828)
Transfers of property and services, net	(22,135,880)	17,395,363	(4,740,517)
Hydropower water storage reallocation deferral	35,651,299	—	35,651,299
Funds received in escrow	(26,583,388)	(13,503)	(26,596,891)
Funds disbursed from escrow	<u>18,396,531</u>	<u>2,910,000</u>	<u>21,306,531</u>
Net cash (used in) provided by financing activities	<u>(112,407,966)</u>	<u>94,970,979</u>	<u>(17,436,987)</u>
Net decrease in cash	(4,740,089)	(9,852,746)	(14,592,835)
Cash, beginning of year	<u>77,463,789</u>	<u>161,955,872</u>	<u>239,419,661</u>
Cash, end of year	<u>\$ 72,723,700</u>	<u>152,103,126</u>	<u>224,826,826</u>
Supplemental cash flow information:			
Interest deferred on regulatory liabilities	\$ 4,203,694	—	4,203,694

See accompanying independent auditors' report.



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SOUTHWESTERN POWER ADMINISTRATION ADDRESSES

WEB: www.swpa.gov

E-MAIL: info@swpa.gov

GORE MAINTENANCE

14165 East 143rd Street South
Gore, OK 74435-9802
Voice: 918-489-5582
Fax: 918-489-5527

TULSA HEADQUARTERS

One West Third Street
Tulsa, OK 74103-3502
Voice: 918-595-6600
Fax: 918-595-6656

JONESBORO MAINTENANCE

305 North Floyd Street
Jonesboro, AR 72401-1908
Voice: 870-972-4686
Fax: 870-932-6153

WASHINGTON D.C.

LIAISON OFFICE
U.S. Department of Energy
Room 8G-027/Forrestal
Washington, DC 20585-1615
Voice: 202-586-5581
Fax: 202-586-6261

SPRINGFIELD MAINTENANCE & OPERATIONS CENTER

2858 South Golden Avenue
Springfield, MO 65807-3213

Maintenance Numbers:

Voice: 417-881-8772
Fax: 417-891-2688

Operations Numbers:

Voice: 417-881-1820
Fax: 417-891-2683



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